

## FACTS ABOUT

# Cap and Trade: Market Oversight and Enforcement

ARB is taking steps in the cap-and-trade regulation design and through market oversight to prevent gaming of the California carbon market.

### Program Registration

All entities must register with ARB to create an account in which to hold allowances. They must disclose under penalty of perjury the following information:

- Name and the basis for qualifying for registration.
- Any direct or indirect associations with other registered entities.
- All registered entities for whose benefit compliance instruments are held.

### Auctions

The auction process is specifically designed to protect against collusion, market power, and/or price manipulation.

- An independent market monitor will review the auction procedures and provide recommendations to ARB on how to ensure fair and competitive auctions.
- The regulation includes a reserve price that limits the potential to manipulate allowance prices at auction.
- The market monitor will review allowance auction acquisition as well as information on account holders' ownership of other allowances.
- Prior to any transfer of auctioned allowances, ARB must first certify the results of the auction.

### Holding and Purchase Limits

The cap-and-trade regulations impose holding limits and auction purchase limits to prevent participants from acquiring market power.

- The regulation limits the number of allowances a market participant can hold at any one time.
- Allowances once placed in a compliance account are permanently retired for compliance purposes.
- Non-utility covered entities may purchase no more than 15 percent of allowances sold at any auction; other entities are limited to four percent of allowances sold at auction.
- Information collected on direct and indirect associations will enable ARB to treat a group of associated entities as a single entity for determining compliance with the purchase and holding limits.

### Tracking of Allowances and Offsets

All compliance instruments, whether emission allowances or offset credits, will exist solely within an ARB centralized allowance tracking system.

- All transfers of compliance instruments must be reported to ARB within three days of settlement of the transaction.
- Both parties to the transfer must report account numbers, the serial numbers of the compliance instruments that were transferred, the date and time of the transaction, and the price that was paid.
- Failure to report is a violation subject to penalties and ARB rejection of the transaction which may cause the instrument to lose value.

### Trading and Enforcement

The regulation expressly prohibits any trading involving:

- A manipulative device.
- A corner or attempt to corner the market.
- Fraud, attempted fraud, or false or inaccurate reports.
- For a violation of the regulations, civil and criminal penalties in the Health & Safety code would apply and, in instances where a signature is required, perjury statutes would also apply for violation of these regulation provisions.

## **Allocation**

Allocation of allowances to industrial producers is based on a facility's production, NOT emissions, so covered facilities benefit from increasing in-state product output and are simultaneously incentivized to reduce emissions.

## **Offsets**

The regulation establishes a rigorous monitoring program for all offsets.

- Offsets verifiers must demonstrate competence in each specific project type, employ conflict of interest assessments and mitigation requirements, and include random verifier audits to ensure that offset verification activities are conducted accurately and properly.
- The program's registry system for compliance instruments is designed to ensure strong enforcement capabilities, including mechanisms to prevent double-counting, and strict ownership and public disclosure requirements.

## **Coordination with the Commodity Futures Trading Commission**

This California carbon market is expected to generate derivatives markets falling under the jurisdiction of the Commodity Futures Trading Commission (CFTC).

- ARB is actively working with the CFTC. CFTC operates a comprehensive market surveillance program which monitors the daily activities of large traders, key price relationships, and relevant supply and demand factors.
- CFTC collects market data and position information daily from exchanges and certain market participants on active futures and option contract markets.

## **Continue Working with Other Trading Operations**

ARB continues to work with other trading programs such as the European Union Emissions Trading System (EU ETS) and the Regional Greenhouse Gas Initiative (RGGI) in an effort to fully minimize potential for market manipulation.

## **Independent Market Oversight**

ARB is pursuing contracts with experts to assist with market monitoring and surveillance efforts.

The Market Monitor will:

- Be independent of other entities performing cap-and-trade market functions.
- Review auction and reserve sale procedures to ensure fair and competitive auctions.
- Audit and monitor the auctions to assess the adherence of participants and the auction operator to established procedures.
- Monitor allowance holding and transfer activity to detect design flaws in the market operating rules, standards, procedures, or practices, or to detect structural problems in the market.
- Prepare reports on market activity and trends.
- Provide advice on market rules on methods to mitigate market risk and improve auction and market efficiencies.

## **The Market Surveillance Committee will**

- Consist of experts in economics, trading, and commodity markets.
- Analyze, advise, and make recommendations on market design, market surveillance, and market oversight.

## **For More Information**

Please contact the ARB Public Information Office at (916) 322-2990, or visit the Climate Change Program web site at: [www.arb.ca.gov/cc/cc.htm](http://www.arb.ca.gov/cc/cc.htm).

To obtain this document in an alternative format or language please contact the ARB's Helpline at (800) 242-4450 or at [helpline@arb.ca.gov](mailto:helpline@arb.ca.gov). TTY/TDD/ Speech to Speech users may dial 711 for the California Relay Service.